

Policymakers Must Not Fiddle While FSLIC Burns

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IT HAS BEEN ARGUED recently that the time has come to permit bank holding companies to acquire healthy thrifts. In fact, nothing could be further from the truth, as this article explains. Furthermore, closing the nonbank bank loophole and recapitalizing the Federal Savings and Loan Insurance Corp. are urgent measures that deserve immediate congressional action. Policymakers cannot continue to "fiddle" while the FSLIC "burns."

With respect to affiliations between bank holding companies and healthy thrifts, it is argued that there is no longer a reason to limit acquisitions to failed or failing thrifts. If the present restrictions are relaxed, according to some, substantial public policy benefits will accrue in that banking organizations would play an expanded role in the solution of thrift industry problems.

A careful examination of the concerns prompting present policy, however, indicates that the Fed and the Bank Board have good reason to continue the prohibition against the acquisition of healthy thrifts by bank holding companies indefinitely. Furthermore, any "benefits" of discontinuing the prohibition are more than out-weighted by the benefits of continuing present policies. Indeed, why would a bank holding company want to acquire a troubled thrift if it could acquire a healthy one in the same state, as a means of gaining entry into that market? The answer is simple: It wouldn't

The underlying concerns behind existing restrictions on thrift acquisitions by bank holding companies remain as cogent today as when they were formulated: namely, the desirability of a separate thrift industry, concern with interstate banking, and the encouragement of acquisitions of failing thrifts as a means of lessening the drain on the FSLIC insurance fund. These policy concerns are so important that they should only be considered and altered by Congress.

The continued existence of a separate thrift industry consisting of lenders dedicated to the financing of home ownership and to local community investment is supported not only by Bank Board Chairman Edwin J. Gray but by Senate and House Banking Committee Chairmen, Sen. William Proxmire and Rep. Fernand J. St Germain, and Federal Reserve Chairman Paul A. Volcker as well. Indeed, despite significant financial institution restructuring in recent years, banks and savings and loans remain different institutions.

The Differences Are Real

While it is true that thrifts enjoy many of the powers of banks, the extent to which they can engage in, for example, commercial lending is very limited. Moreover, savings and loans can engage in many activities that are not permitted for commercial banks, such as real estate development, property management, and the operation of insurance agencies. Also, thrifts and banks operate under completely different regulatory structures. Large scale affiliations between banks and thrifts could create significant, and perhaps unmanageable, conflicts between state and federal, and bank and thrift, regulators. Thus, the differences between banks and thrifts remain real not imaginary.

Interstate banking concerns are also valid today. Even though more and more states are enacting interstate banking laws, true nationwide interstate banking is not yet upon us. Indeed, individual states should be permitted to control the extent and timing of interstate banking unless Congress chooses to act in this area. In fact, legislation to implement phased-in nationwide banking had little or no support in the last Congress.

The third concern that prompts restrictions on the acquisition of healthy thrifts by bank holding companies - that bank holding companies will not undertake the acquisition of troubled thrifts - is of paramount significance today. The FSLIC insurance fund is running out of money; and the FSLIC is burdened by the cost of solving intractable financial difficulties at many of the institutions it insures.

Indeed, the exception to the general prohibition against the ownership of thrifts by bank holding companies - namely, to prevent the failure of a thrift, a bank holding company can expand into markets that may otherwise be inaccessible at the price of assuming the financial and managerial burden of the troubled thrift - is a vital tool for the FSLIC in stemming the depletion of its insurance fund.

The Importance of the FSLIC

The FSLIC achieves the resolution of a problem case at a cost that is usually much lower than that of liquidating the thrift; and the banking system is spared the loss of public confidence that would result from large scale liquidations of troubled thrifts.

At a time when the FSLIC is seeking a much needed recapitalization of its insurance fund, which has declined significantly as huge expenditures have been incurred to solve the problems associated with sick savings and loans, the FSLIC doesn't need to see its list of potential acquirors evaporate overnight.

According to Chairman Gray, the FSLIC has 327 savings and loans in its "significant supervisory caseload." The FSLIC estimates that it will need at least \$25 billion over the next few years to resolve these problem cases. In light of such demands, now is not the time to remove incentives for bank holding companies to acquire troubled thrifts, by allowing them to acquire healthy ones. Indeed, such a public policy reversal would constitute nothing short of lunacy at this time.

The FSLIC desperately needs to achieve the resolution of financial difficulties at troubled thrifts in ways that bring in much needed new capital, so that the viability of its fund will not continue to be threatened and the maximum number of competitors in the marketplace will be preserved and fostered.

The high number of problem thrifts is precisely the reason that warranted a limited exception to the general policy of prohibiting bank holding companies from acquiring thrifts as subsidiaries at all. Such an exception already plays to the self-interest of those bank holding companies that are bent on interstate expansion (such as Citicorp). By so confining or limiting any exception to the general prohibition against bank holding company acquisitions of thrifts, legitimate (as opposed to transparent) public policy interests are served.

Limited Interstate Movement

To date, it is true that bank holding companies have not availed themselves in great numbers of the opportunity to expand on an interstate basis by acquiring troubled thrifts. This stems in part from a lack of knowledge on the part of acquirors as to the attractiveness of FSLIC deals; and to substantial operational restrictions imposed by the Fed in connection with such acquisitions.

Indeed, Chairman Gray has urged the Fed to relax such restrictions, presumably in order to make the acquisition of troubled thrifts more attractive. If any change in policy is warranted at this time in light of

the FSLIC's problems, it ought to be the relaxation of such restrictions, not permission for bank holding companies to acquire healthy thrifts.

Only by acquiring a troubled thrift can bank holding companies play a constructive role in the resolution of the thrift industry's problems at this time. Healthy institutions, by definition, need no rehabilitation or resolution. If bank holding companies are to play a part in rehabilitating the thrift industry, the most obvious role would be to apply capital and intense management skills to turn foundering institutions into healthy ones.

If bank managers feel the need to develop greater familiarity with the management of a thrift before investing heavily in the industry, as has been suggested, there could be no better way to become thoroughly educated in the operations of such institutions than to work on solving the problems of a failing thrift.

Let there be no illusions, permission for bank holding companies to acquire healthy thrifts would achieve only one end: inexpensive expansion as healthy thrifts are snapped up at lower book-value multiples than would have to be paid for similar healthy banks. There would be no incentive for bank holding companies to acquire troubled thrifts if they could acquire healthy ones; and no public policy purposes would be served in the process.

In addition to maintaining the prohibition against the acquisition of healthy thrifts by bank holding companies, two other initiatives must be addressed immediately in order to aid the FSLIC in solving its problem caseload now and over the next few years: closing the nonbank bank loophole and recapitalizing the FSLIC. The ownership of nonbank banks would afford bank holding companies the opportunity to expand on an interstate basis in a manner that was never intended by Congress and that would be detrimental to the FSLIC insurance fund.

The Nonbank Issue

Although the Controller of the Currency has been enjoined from chartering further national nonbank banks, there are over 350 applications pending from bank holding companies to establish such entities. It is expected that the nonbank bank issue will be resolved by Congress later this year; however, as long as bank holding companies (and commercial firms as well) have a hope of establishing nonbank banks, they will not be enthusiastic bidders for troubled thrifts, if they are bidders at all. There are many public policy reasons why the nonbank bank loophole should be closed, not the least of which is to

encourage would-be nonbank bankers to expand instead through the acquisition of troubled thrifts.

In addition, the prompt recapitalization of the FSLIC is also absolutely essential to the timely and efficient rehabilitation of the thrift industry. The reserves of the FSLIC have dwindled to \$1.9 billion; whereas, just one year ago, they stood at \$4.5 billion. According to the FSLIC, if the present operating losses of the 327 institutions in the FSLIC's "significant supervisory caseload" continue unabated in 1987, such losses will total \$2.2 billion, more than the FSLIC's 1986 income.

Since these losses continue to mount on a daily basis, if the recapitalization of the FSLIC is delayed, existing recapitalization proposals will not generate enough money to resolve the FSLIC's caseload. Thus, it is clear that the FSLIC must be recapitalized immediately so that the problem caseload can be resolved expeditiously and efficiently. In the absence of recapitalization, the FSLIC may soon be unable to deal with current problems that need immediate attention, let alone the problems of the future.

In summary, the public benefits attributed by some to relaxing the present prohibition against healthy thrift acquisitions are pure poppycock. Bank holding companies are already permitted, even encouraged, to play a role in the solution of the thrift industry's problems and to develop an interest in the operation of thrifts through the acquisition of troubled thrifts. What better way for bank holding companies to serve the public interest?

The acquisition of healthy thrifts by bank holding companies would serve no public policy purpose at this time; contrariwise, it would merely add another "loophole" to the crazy quilt scheme of interstate banking that is already developing. The number of troubled thrifts remains high, and every incentive should be held out to prospective acquirors that might aid in eliminating expensive and undesirable liquidations of problem thrifts.

To that end, the policy of restricting thrift acquisitions by bank holding companies to the acquisition of troubled thrifts is sound. The Bank Board and the Fed should be commended for their present policies and encouraged to retain them indefinitely.

In addition, Congress should act immediately to close the nonbank bank loophole in order to provide further incentives for the acquisition of troubled thrifts. It should also pass FSLIC recapitalization legislation immediately in order to give the FSLIC funding, which it so desperately

needs to solve its problems and rehabilitate troubled institutions with the help of able acquirors and merger partners.

Seventy-nine percent of the industry is doing well; and the present interindustry strictures that serve to maintain savings and loans as a separate system of depository institutions should be steadfastly maintained at least for the foreseeable future. There is no question that the FSLIC and the savings and loan system are worth saving; however, each day that passes with no action being taken on such important issues further jeopardizes these institutions and forecloses the policy options available.

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